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No. 94-1340

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

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CITIZENS BANK OF MARYLAND,

Petitioner,

v.

DAVID STRUMPF,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

BRIEF OF THE AMICUS CURIAE AMERICAN BANKERS ASSOCIATION IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether a bank creditor may refuse a bankrupt depositor's request to withdraw funds pending determination by the bankruptcy court of the bank's setoff rights without violating the automatic stay provisions of the Bankruptcy Code, 11 U.S.C. § 362(a).

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The American Bankers Association hereby respectfully submits this brief as amicus curiae in support of the Petitioner in accordance with the provisions of Rule 37.2 of the Supreme Court Rules. The parties have consented to this filing, and their written consents are filed with this brief.

INTEREST OF THE AMICUS CURIAE

The American Bankers Association is the principal trade association of the banking industry in the United States, representing banks located in each of the fifty states and the District of Columbia, including both national and state-chartered banks, and banks of all sizes, from small community banks, through regional and super-regional banks to money center banks. The Association's membership includes both independent and holding company owned banks, whose combined domestic assets total some ninety percent of all banking assets in the United States.

On behalf of its member banks, the American Bankers Association has a distinct interest in the question presented by this case in several respects. The question presented here is one that, through frequently recurring litigation, has divided the lower courts and has not been previously addressed by this Court. The interpretation of and interplay among the several provisions of the Bankruptcy Code at issue here are important to the day-to-day operations of banks, and, consequently, a definitive clarification of the law is devoutly to be desired. In addition, it is important that the decision of the Fourth Circuit be reviewed and reversed, for it endangers the very foundation of an increasingly important product offered by members of this Association and other lenders, more of which below.

REASONS FOR GRANTING THE WRIT

This is a "banker's dilemma" case in which the Respondent was both a depositor in and a borrower from the

Petitioner bank. The Respondent specifically and clearly agreed, by written contract, that the bank would have the right to set off amounts owed to the bank against funds that the Respondent had on deposit in the bank in the event of default. The Respondent did, in fact, default on the loan and filed for bankruptcy. Under the Bankruptcy Code, the Debtor is entitled to an "automatic stay" of proceedings to collect debts against the Debtor. (11 U.S.C. § 362(a)).

When the Respondent filed for bankruptcy, the bank did not immediately exercise its right of setoff against the Respondent's deposit account, but rather imposed an administrative hold on a portion of the deposit account sufficient to protect its contractual rights, so as to preserve its ability to set off if and when the automatic stay were lifted. Under the administrative hold, the bank would refuse to honor checks drawn against the Respondent's account that would reduce the balance below the amount the Respondent owed.

The Fourth Circuit held, in the case below, that the bank's actions violated the automatic stay provisions of the Bankruptcy Code. But failure or inability by a bank to impose an administrative hold on a deposit account under these circumstances is tantamount to forfeiture of the bank's rights--a drastic outcome imposed upon no other type of creditor. The bank was compelled to lift its administrative hold on the Respondent's funds under penalty of contempt of court. That permitted the Respondent to withdraw all funds from the bank, which, of course, he did, thereby depriving the bank of the security for which it bargained. It did the bank no good for the lower courts to hold--as they did, well

after the fact--that the bank was entitled to relief from the automatic stay. By that point, the banks' contractual rights had long since been spirited away in fact, and it had no effective remedy for that abuse. (*See, e.g.*, L. King, 2 *Collier on Bankruptcy*, ¶ 363.04 at 363-23; *Standards and Sanctions for Use of Cash Collateral under the Bankruptcy Code*, 63 Tex L.Rev. 341 (1984); *In re Williams*, 61 B.R. 567, 576 (N.D. Tex. 1986).

Section 362(a)(7) of the Bankruptcy Code provides, in relevant part, that "a petition filed under section 301, 302 or 303 of this title...operates as a stay, applicable to all entities, of--...the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor." It obviously does no violence to the plain language of the statute to permit a bank to impose an administrative hold on its depositor's funds. Doing so does not convert the depositor's funds to the bank's own, nor does it permit the bank to exercise dominion and control over those funds. It merely prevents the **depositor** from doing so, thereby preserving the status quo pending determination by the Bankruptcy Court of the respective rights of the parties. It is the only feasible way for the bank to implement the provisions of Section 542(b) of the Bankruptcy Code: "[A]n entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, **except to the extent that such debt may be offset under section 553 of this title against a claim against a debtor.**" The Fourth Circuit decision below effectively strips this section of the Bankruptcy Code

of any meaning and effect, at least in the context of the fairly common fact pattern presented here.

As the Petition for Writ of Certiorari correctly points out, other courts have reached conclusions at odds with the Fourth Circuit's in comparable cases. *See, e.g., In re Patterson*, 967 F.2d 505 (11th Cir. 1992); *In re Davis*, 889 F.2d 658 (5th Cir. 1989), *cert. denied sub nom. Campbell v. United States*, 495 U.S. 933 (1990); *In re Edgins*, 36 B.R. 480 (Bankr. 9th Cir. 1984)[1] Inconsistent results in the lower courts on fundamental issues of bankruptcy law is quite a sufficient independent reason for the Court to grant the Petition for Writ of Certiorari under Rule 10 of the Supreme Court Rules, and no point would be made by our repetition of the arguments to that effect already before the Court in the Petition for Writ of Certiorari.

In addition to that, however, the precedent set by the Fourth Circuit decision, if it stands unreviewed and unreversed, will endanger an important banking product that is not even directly involved in this case. This case involves a fairly conventional loan product and fairly conventional checking account. As unjust as the result is to the bank in this case and to any bank similarly situated in the future, the consumer lending business and the checking account business will go on. The same may not necessarily be said for the secured credit card business.

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[1] *Contra*: *Small Business Administration v. Reinhardt*, 887 F.2d 165 (8th Cir. 1989); *United States v. Reynolds*, 764 F.2d 1004 (4th Cir. 1985); *United States v. Norton*, 717 F.2d 767 (3d Cir. 1983).

A "secured credit card" looks and acts, in the marketplace, exactly like an ordinary Visa card or Mastercard. It allows customers to "charge" purchases of goods and services; the customer is billed on a monthly basis and is allowed to carry a balance from one month to the next after making a required minimum payment. The primary difference between a secured credit card account and a conventional credit card account is that the secured card holder is obligated to maintain a deposit balance in the issuing financial institution. The required balance is tied to the line of credit available to the customer. Most issuers require a deposit equal to 100 percent of the line of credit, some a bit more, some a bit less. Typically, a secured credit card account costs the customer somewhat more than is charged in the case of a conventional credit card, in terms of annual fees, application fees or interest rates or some combination thereof.[2] That being the case, the only customers who would choose to open a secured credit card account are those who--almost by definition--are not creditworthy enough to qualify for a conventional credit card account. Stated from the opposite perspective, a safely and soundly run bank would not and could not extend credit to secured credit card customers if it could not count on the security of the required deposit account for each of those customers.

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[2] *See* RAM Research Corporation, "Secured Card Survey," *CardTrak*, Issue 48, December, 1994 at 7, for selected terms and conditions offered by various issuing institutions.

The benefit to customers of a secured credit card account, in addition to the convenience of charging purchases, is that it enables them to establish creditworthiness so that, after a time, they will be eligible for a conventional credit card. The primary beneficiaries of secured credit card programs are young people, just starting out, recent immigrants with insufficient time to have established a credit history in this country, widowed or divorced persons who had never established credit histories independent of their spouses, and people with impaired credit histories[3]--the very people to whom the Bankruptcy Code is designed to grant a "fresh start." *Wetmore v. Markoe*, 196 U.S. 68, 77 (1904).

The secured credit card market is not insignificant. There are already 1.5 to 2 million cards outstanding and the market has only begun to be tapped. There are an estimated 13 to 14 million people who do not have a credit history and another four to six million who have impaired credit records.[4] Approximately 300 financial institutions now offer secured credit cards.[5]

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[3] Phillips Business Information, "Secured Cards Gain Popularity as a Way to Reach Niche Segments," *Credit Risk Management Report*, August 15, 1994 at 1.

[4] Fickensher, *Big Banks Looking to Secured Cards for Growth*, American Banker, March 1, 1995 at 14.

[5] Lucas, "The Shakeout in Secured Cards," *Credit Card Management*, October 1994 at 54.

The balance required of a customer under a secured credit card program is a deposit account, just as was the deposit account involved in this case. It is every bit as much the "cash collateral" within the meaning of Section 363(a) of the Bankruptcy Code as the deposit account involved in this case. If, as the Fourth Circuit held below, there is no effective way for the bank to have prevented a withdrawal of funds by the Respondent in this case--despite contractual and statutory protections of the bank's rights--it is hard to imagine how a secured credit card lender could prevent its borrower from withdrawing the required funds on deposit after defaulting on his or her credit card loans and filing for bankruptcy. If that is to be the case, the entire logical underpinnings of the secured credit card program disappears. No longer will lenders be able to extend credit to otherwise noncreditworthy persons. That outcome is counter to sensible public policy, and benefits no one--not the lender, not the customer.

CONCLUSION

For all of the reasons set forth in the bank's Petition for Writ of Certiorari and because of the importance of the issue, as outlined above, to an entire marketplace not otherwise represented in this litigation, the American Bankers Association, as amicus curiae, respectfully urges the Court to grant the Petition.

Respectfully submitted,

/s/

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